

BEFORE THE SECURITIES AND EXCHANGE BOARD OF INDIA

CORAM: Dr. T.C.NAIR, WHOLE TIME MEMBER

**IN THE MATTER OF FREEDOM INVESTCO PVT. LTD, SUB BROKER
AFFILIATED TO LSE SECURITIES LTD, MEMBER, BOMBAY
STOCK EXCHANGE LTD., SEBI REGN. INS010692338 AND NATIONAL
STOCK EXCHANGE OF INDIA LIMITED SEBI REGN. INS230967437**

ORDER

Under Regulation 13(4) of SEBI (Procedure for Holding Enquiry by Enquiry Officer and Imposing Penalty) Regulations, 2002 against Freedom Investco Pvt. Ltd., Sub-broker affiliated to LSE Securities Ltd., Member, BSE and NSE.

1.0 Background

1.1 Freedom Investco Pvt. Ltd. (hereinafter referred to as "FIPL") is a sub broker affiliated to LSE Securities Ltd., member of Bombay Stock Exchange Ltd. (hereinafter referred to as "BSE) and National Stock Exchange of India Ltd. (hereinafter referred to as "NSE") and registered with the Securities and Exchange Board of India (hereinafter referred to as "SEBI") under Section 12 of Securities and Exchange Board of India Act, 1992 (hereinafter referred to as "the Act") with registration numbers INS010692338(BSE) and INS230967437 (NSE).

1.2 SEBI conducted an inspection of the books of accounts, documents and other records maintained by FIPL for the period from April 2000 to March 2002 (hereinafter referred to as inspection period), under Regulation 19 of the SEBI (Stock Brokers and Sub-brokers) Regulations, 1992 (hereinafter

referred to as “Stock Brokers Regulations”) and the same was carried out by M/s Krishan Sindhwani & Co., Chartered Accountants on behalf of SEBI.

1.3 Certain irregularities/contraventions of concerned SEBI Regulations were observed during the said inspection as under:

- i. Installation of trading terminals other than specified /authorised places.
- ii. Client bank account not being maintained separately
- iii. Non maintenance of order book
- iv. Discrepancies in contract notes and confirmation memo
- v. Delay in pay out of funds to clients
- vi. “Know Your Clients” form not obtained or incomplete
- vii. Dealing with unregistered sub-brokers

1.4 A copy of the findings of the Inspection Report was sent to the FIPL vide letter dated April 2, 2003. FIPL submitted its reply vide letter dated May 8, 2003.

2.0 Enquiry Proceedings

2.1 Pursuant to the above, an Enquiry Officer was appointed by SEBI vide order dated December 11, 2003 in terms of the provisions of Regulation 5 (1) of the SEBI(Procedure for holding Enquiry by Enquiry Officer and Imposing Penalty) Regulations, 2002 (hereinafter referred to as “Enquiry Regulations”) to enquire into the irregularities / violations committed by FIPL.

2.2 In terms of Regulation 6 (1) of the Enquiry Regulations, a show cause notice dated April 29, 2004 was issued to FIPL. The said notice referred to the inspection of SEBI containing the details of various

provisions of law and the of violations alleged to have been committed by FIPL. FIPL vide its letter dated May 29, 2004 replied to the aforesaid show cause notice and also requested for a hearing before the Enquiry Officer.

2.3 An opportunity of hearing was granted to FIPL before the Enquiry Officer on October 27, 2004, November 9, 2004, December 09, 2004 and December 28, 2004. However, FIPL inspite of giving several opportunities for hearing failed to attend the same and therefore, the Enquiry Officer proceeded further on the basis of material available on record. The Enquiry Officer submitted his reports dated January 19, 2005 and March 31, 2005 recommending a penalty of suspension of certificate of registration for a period of three months.

3.0 Show Cause Notice and Reply

3.1 Show cause notices dated February 04, 2005 and April 04, 2005 were issued to FIPL, in terms of Regulation 13(2) of the Enquiry Regulations, advising them to show cause as to why the penalty as considered appropriate should not be imposed upon them. Copies of the Enquiry Reports were also forwarded to FIPL with the said show cause notices and the same were served on FIPL through BSE and NSE.

3.2 FIPL submitted its replies to the above show cause notices and inter alia stated as under :

(i) *As regards non maintenance of client bank account separately, there is no litigation pending against the company; neither there is any complaint with any authority for non payment of financial dues to their clients. FIPL is of the view that it could be due to the clerical oversight that certain limited general transactions might have taken place from accounts kept exclusively for clients which was not a routine practice. The transactions of cash withdrawals from these accounts were because cash had to be moved*

manually to Ludhiana, as no bank in the Border District was online, for sufficing the pay in clients.

- (ii) FIPL's business started only in the period when online trading was in place. Every order placed, modified, changed, matured and pending along with time is logged and is available in soft copy. FIPL had maintained data in the form of logs of transactions. Due to online trading, maintenance of physical order meticulously was not possible.*
- (iii) In the matter of discrepancy in contract notes and confirmation memo, FIPL got transformed from the status of main broker to sub broker and the phasing out was an overlapping process. FIPL was transacting for a short period as main broker and also sub broker. FIPL, however, issued confirmation memos which fulfilled all the conditions laid down by SEBI.*
- (iv) FIPL has executed 'Know Your Client' form with all its clients. Discrepancies observed are not justified because those clients who gave identity proof in the form of driving license, voters identity card, passport, pan card etc. and also have given their photographs.*
- (v) With regard to delay in payment to clients, FIPL stated that they took consent forms from those clients who had multiple transactions with them or who insist on retaining their payments and delivery of margin against their future trades. FIPL has a proper procedure for making delivery of securities purchased by their clients. Giving delivery of securities in Demat account is done by FIPL while cheques have to be collected by the clients themselves. The payments due to the clients have always been available in the clients account of the company.*

3.3 An opportunity of personal hearing was granted to FIPL before me on July 13, 2006 at the Regional Office of SEBI, New Delhi. However no one appeared on behalf of FIPL. Another opportunity of hearing was granted to FIPL on February 26, 2007 which they did not avail. It appears that FIPL is not interested in availing the opportunity of personal hearing and therefore, I am inclined to proceed further based on the records available with me.

4.0 Consideration of Issues

4.1 I have carefully examined the inspection report, enquiry reports and the submissions of FIPL. The facts and finding of the enquiry reports dated January 19, 2005 and March 3, 2005 are materially identical and therefore my observations for both the cases are as under:

4.4.1 Installation of Trading Terminals in places other than specified places.

The enquiry officer found that as the trading terminals were installed at the branch offices of FIPL and the same are operated by its employees / directors, I find that there is no misutilisation of their trading terminals. The submission of FIPL is therefore accepted.

4.1.2 Improper Maintenance of Client Bank Account

The enquiry officer found that FIPL did not maintain separate bank accounts for their clients. All the bank accounts maintained by FIPL had both types of transactions i.e. general as well as relating to the clients in violation to the SEBI circular no. SMD/SED/CIR/93/23321 dated November 18, 1993. FIPL submitted that there was no misuse of client bank account and there was no litigation or claim pending against it. Due to clerical oversight certain limited general transactions may have been taken place from accounts kept exclusively for clients, which was not a routine practice. I note that sub brokers are required to maintain a separate bank account for their client exclusively for the transactions relating to clients. I am of the view that as per the aforesaid circular a separate account should be maintained for the clients. I agree with the finding of the Enquiry Officer that mere submission by FIPL that it was using that part of client account only which corresponded to brokerage / pay in, does

not absolve it from the responsibility of maintaining separate client account. As FIPL has admitted the lapse on its part and since there was no finding of misuse of clients funds, I am inclined to take a lenient view.

4.1.3 **Non Maintenance of Order Book**

SEBI vide its circular dated February 11, 1997 has mandated the brokers / sub brokers to maintain an order book which should contain the record of time when the client has placed the order and reflect the same in the contract notes along with the time of executing the order. The order books should also contain the identity of the person placing the order and the terms and conditions of the order along with a record of the modifications /cancellations, if any. The enquiry officer found that FIPL did not maintain the above records which are necessary for better internal control and management. FIPL submitted that it was maintaining copy of sale/purchase note, which serves the purpose of order book. However, same is not acceptable as the order book may also contain unexecuted orders for which no sale / purchase note would have been issued. Further, I do not agree with the FIPL's submission that due to online trading, a physical order book cannot be maintained meticulously. I am of the view that the order book shows the time of placement and execution of the order which is very important from the investor's perspective. I note that the Hon'ble Tribunal in Appeal no. 367 of 2004 in the matter of *Shubam & Co. vs. SEBI* while dismissing the appeal observed as under:

Stock brokers are required to maintain some record where the time when the client places an order must be recorded and the same should be reflected in the contract note along with the time of execution of the order. Admittedly, the appellant has not been maintaining any such record which is usually maintained in a register commonly known as order book. Clause 7 of the circular may appear to be innocuous but it is not so and is very important step which the Board has taken to

protect the interest of the investors. In a volatile market like ours where the prices of the scrip fluctuate every moment, it is absolutely necessary that a broker should record the time when it receives an order from a client and also the time when the same is executed. If this is not done the brokers could take the investors (their clients) for a ride and make undue benefit for themselves. It is for this reason that the Board has made it mandatory for the stock brokers to maintain such record. Having issued the circular the Board would be well advised in ensuring strict compliance thereof by every stock broker so that the interest of the investors do not get jeopardized.”

In view of the above finding of Hon’ble SAT and the submission of FIPL, I find that FIPL has violated the provisions of the aforesaid circular.

4.1.4 Discrepancies in Contract Notes and Confirmation Memo

The enquiry officer found that the contract notes /confirmation memos issued by the FIPL had following discrepancies:

- (i) It did not contain the date and time of receiving the order and settlement number of a particular transaction.
- (ii) Duplicate of contract notes did not contain signatures of the clients who had received the original copies.
- (iii) The counterfoils did not contain the signatures of the clients/who had received the original copy.
- (iv) The revenue stamps required to be affixed on the contract note were not being affixed.
- (v) FIPL was required to issue confirmation memo on account of transactions executed as sub-broker, but instead it had issued contract notes for the same with regard to the transactions detailed in the inspection report.

FIPL submitted that the discrepancies mentioned about the contract notes do not arise because it had issued confirmation memos/ sale and purchase notes which fulfill all the conditions as required by SEBI. The contract notes were issued as a broker of LSE and in respect of the trades executed at LSE only. FIPL had stopped operating as main broker after November 27, 2001 and hence it did not issue any contract notes after the aforesaid date. The question of discrepancies such as missing signature, revenue

stamps, details of transactions etc. as pointed out in the inspection reports did not arise as the inspection was for FIPL's sub-broker status and not for main brokers status. I agree with the findings of the Enquiry officer wherein it was found that the contract notes were issued by FIPL as its activity as a main broker at LSE and that it had stopped working as a main broker after November 27, 2001. However it was noted that present inspection was with regard to the sub-broking activity conducted for FIPL. I also note that the annexure IV to the inspection report clearly specifies 22 cases where contract notes were issued instead of confirmation memos. In view of the above, I find that FIPL has violated the SEBI Circular no. SMD/MDP/CIR/043/96 dated August 5, 1996 and SMD/Policy/Cir/11/97 dated May 21, 1997.

4.1.5 Delay in Pay Out of Funds to Clients.

The enquiry officer found that FIPL did not have any set procedures to make the payments to clients strictly within 48 hours from the time of pay-out of particular settlement. It was further noted that FIPL had dealt with 480 clients while it had consent letters of 165 only. The inspection report clearly specifies list of 315 clients of FIPL to whom neither payment within 48 hours of the pay out of a particular settlement was made nor any consent letter to retain their money for future transactions was obtained. FIPL submitted that it has set procedures for making delivery of securities purchased by their clients. For those clients who insists that FIPL retain their payments/ deliveries as margin for further trading, written consent has been obtained from these clients. FIPL has consent letters of 165 clients and obtains consent forms from those clients who have multiple transactions with them or who insists to retain their payments and delivery for the margin against their future trades. Further no claim or

litigation, complaint or arbitration is pending against FIPL as regards unpaid dues to their clients even after seven years of business. In view of the above, I am inclined to take a lenient view.

4.1.6 Know Your Clients Form not obtained or incomplete

The enquiry officer found that FIPL did not obtain “Know Your Client” Form (KYC) from the clients. Further the KYC form received from the sub-brokers record does not contain all the required information. It was further alleged that FIPL has violated the provisions of circular no. SMD/POLICY/CIRCULAR/5-97 dated April 11, 1997. FIPL submitted that it had executed KYC form with all their clients. Further the discrepancies observed in the KYC form as per the annexure 9 of the inspection report were not justified because those clients who give identity proof in the form of driving license, voter identity card, passport, pan card etc. have given their photograph in the photostat copy of the above. In the matter of not having PAN declaration of all the clients, FIPL stated that it is not mandatory and it is compulsory only for the clients who place orders of Rs. 1 lakh or above. After perusal of the inspection report, it is found that the inspection report clearly specifies the list of 349 cases where KYC form has not been obtained. As regards non mentioning of PAN and other discrepancies like not having photograph cannot be condoned. It may be treated as procedural lapse in view of the submissions made by FIPL. I am of the view that FIPL has violated the provisions of the directives of the aforesaid circular and therefore in future it should be careful as regards maintenance of the client database.

4.1.7 Dealing with unregistered sub-brokers

I note that in terms circular dated SMDRP/POLICY/CIR-49/2001 dated October 22, 2001, the trading terminals can be installed only at the registered office / branch office / registered sub broker's office. FIPL has submitted that the trading terminals are installed at its branch offices which were operated by its employees /directors. The Enquiry Officer has accepted the submission of FIPL and found that it has not dealt with unregistered sub-broker. In view of the above, I agree with the finding of the Enquiry Officer.

4.1.8 On careful perusal of the charges and the findings as recorded above, I note that FIPL has admitted their lapses with regard to non maintenance of order book, discrepancies in issuing confirmation memos, delay in making payment to clients, KYC forms, etc. which have to be viewed seriously. However after considering all the above facts and circumstances of the case, I am of the view that penalty of three months as recommended by the Enquiry Officer is excessive. In my view, a penalty of suspension of certificate of registration for a period of one week would be adequate to meet the ends of justice.

5.0 Order

5.1 Now therefore in exercise of the powers conferred upon me in terms of Section 19 of the SEBI Act, 1992 read with Regulation 13(4) of the said Regulations, I hereby impose a minor penalty of suspension of certificate of registration for a period of one week on M/s Freedom Investco Pvt. Ltd., Sub Broker affiliated to LSE securities Ltd., Member of the Bombay Stock Exchange Ltd. (INS010692338) and National stock exchange of India Limited (INS230967437).

5.2 This order shall come into effect on expiry of 21 days from the date of this order.

Date : 17.09.2007

Place : Mumbai

T. C. Nair
Whole Time Member
Securities and Exchange Board of India